



2001 has been a tough year – but we believe we now have the right strategy, skills and people to grow the business.

**2001 Operating performance**

2001 has been a tough year with the general economic environment, unprecedented downturn in the US apparel industry and major changes in group structure all adding up to a serious management challenge. In the circumstances, we believe the profits and cash flow achieved demonstrate the resilience of the core business. Detailed comments on performance are contained in the operating reviews, but it is clear that the Thread business was severely impacted by an exceptionally large stock reduction at all stages in the US apparel supply chain. The other notable impact on results was the decline in demand at Jaeger following 11 September. Action was taken in both areas to reduce the cost base. Other parts of the Thread business delivered improvement in performance and both Bedwear and Viyella continued to deliver a steady profit performance.

**Strategic progress**

Within the business we recognise the need to improve profitability and restore organic growth without undue dependence on general economic recovery. During 2001, despite the difficult trading environment, we made strategic progress in several areas which will provide the foundations for future growth. One of the key steps was the creation of a more appropriate management structure including the appointment of Bryan Anderson as Chief Operating Officer, Thread. There was substantial progress on the disposal of non-core businesses and we start 2002 with much clearer focus.

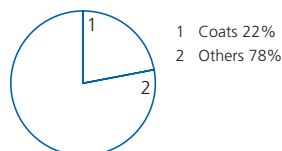
**Core business strategy – positioned for growth**

Within the textiles sector, our Thread business is uniquely positioned for growth. As our customers become more global, our worldwide organisation, relative size and product offer create strong competitive advantage. Over 80% of North American and Western European consumption of clothing and footwear is now supplied from lower cost regions and a further phase of migration is expected over the next few years as clothing businesses position their sourcing and manufacturing in anticipation of the phasing out of textile and apparel quotas by 2005. As the only sewing thread manufacturer able to offer a comprehensive product range which can be manufactured to customer specifications in all of the key low cost markets, global trends in textiles, apparel and footwear can be turned to our advantage with our size also bringing advantage in raw material purchasing. In addition, the Barbour acquisition has opened up a whole new segment of speciality threads.

**Optimising the supply chain**

Although our strong relationships with customers in Western markets remain a key competitive advantage, the corresponding thread production capacity in the EU and US has become less appropriate. The need for Coats to follow its customers by investing in new plants in low cost markets such as China whilst simultaneously incurring reorganisation costs in downsizing Western capacity has been a dominant feature of our results for some

**Thread Market share Low cost production**



80%

The global thread market is worth £3.8 billion. Coats has a 22% share.

Over 80% of North American and Western European consumption of clothing and footwear is now supplied from lower cost regions.

## 6 Chief Executive's review (continued)

Our aim is to exploit the advantages of our unique global position to generate solid and sustainable returns.

years. Much progress has already been made with the relocation of upstream spinning capacity from Western Europe and the US to lower cost locations. However optimisation of the global supply chain is expected to take another three years. Over this period, reorganisation costs are expected to total around £50 million pre-tax. Thereafter, although it is unlikely that apparel migration will totally cease, the cost of keeping up with customer moves is expected to be significantly lower.

The optimisation of our supply chain will extend our lead as the lowest cost international producer and ensure that our service capability remains well ahead of competitors. Combined with the opportunities created by changing markets, we believe we are well placed to deliver sustained improvement in shareholder value.

### Marketing initiatives beginning to deliver results

The migration of apparel and footwear manufacture has been accompanied by increased interest from retailers and brand owners in tighter control of component specification as their supply chain becomes more complex. In response, our global key account programme was launched in 2000 with the objective of securing supply partnerships with the world's largest brands. So far we have entered into supply partnerships with 37 major global retailers or brand owners. New partnerships struck in 2001 include American Eagle Outfitters, Haggar Clothing Company, Sears, Next, French Connection, Liz Claiborne Kids, Saks Fifth Avenue Enterprises and Nike.

We continue to invest in innovative services for key customers, building on a global offer for thread product which assures uniformity of quality, shade range, appearance and sewing performance, wherever the customer chooses to source or manufacture. The Coats Sewing Solutions programme is designed to provide an array of additional services, aimed at improving garment quality and shop floor productivity.

In the area of productivity, Coats has taken the lead in the apparel industry in promoting the use of high performance coespun thread in the developing world. We expect this initiative to lead to a growth in total market value as well as in our market share.

New initiatives currently under trial include a colour management tool for the apparel supply chain drawing on a number of proprietary in-house technologies and a B2B solution which allows easy, transparent engagement with Coats supply centres across multiple country locations.

### Acquisitions policy

We are confident that our current market position and strategy will result in organic growth and improved financial returns, especially once the remaining parts of our supply chain strategy are implemented. However, as can be seen with the success of the Barbour and DMC acquisitions, earnings growth prospects would be enhanced if we were able to gain additional presence in certain product

Thread

Partnerships

Overlooked asset

# 37

## International senior management team

We have, so far, forged supply partnerships with 37 major global retailers and brand owners who source their products from more than 50 countries involving thousands of manufacturers – all serviced by Coats.

Our lead over competitors does not lie purely in physical infrastructure. Our international management cadre, built up over many years, allows Coats to manage operations in complex and diverse commercial and cultural environments.

## Uncertainty over economic recovery in North America and Western Europe suggests progress in 2002 will be weighted to the second half.

segments and/or regions. We are better placed than most to extract synergies and therefore intend pursuing a more active acquisitions policy, but completion will ultimately depend on availability at a price which adds value for shareholders.

### Fashion Retail

2001 has been a disappointing year for Jaeger with a great deal of good work on rejuvenating the brand, developing the range, improving product quality and on-time delivery and developing a new store design not rewarded in terms of financial results. Viyella continued to perform steadily with improvements in quality and delivery.

### Bedwear

After the disruptive process of disposing of a series of ancillary home furnishings activities during 2001 the business is now focused on developing its core competencies in design and manufacturing while developing sourcing to reduce the cost of more basic components of its range.

### India

Further good progress has been made with the phased withdrawal from the uncompetitive textiles business in India in order to focus on the profitable and growing thread business. This withdrawal will result in exceptional costs of approximately £15 million over two to three years. Following a share buyback last year Coats has increased its shareholding in the Indian subsidiary from 51.5% to 63.2%.

### Competition inquiry

In November, The European Commission announced it was conducting an investigation into the supply of haberdashery and thread products. The investigation is still underway and Coats has made it clear publicly and privately that it wishes to co-operate fully with the investigating authorities. The Company has been advised that the investigation is likely to continue for some months before resolution.

### Prospects

In the short term, much depends on the speed of recovery in US thread demand although stock pipelines are relatively empty. It is likely that Thread will make progress over the full year. This is expected to be concentrated in the second half as activity so far remains below that seen in the strong first half of 2001.

Bedwear has stabilised and should show improvement on 2001 results. Jaeger on the other hand, has so far seen little sign of recovery from the depressed levels of demand seen in the last quarter. Overall, on the basis of an upturn in demand in North America, we expect to make modest profit progress over the full year.

Business-to-Business

Productivity improvement

# B2B

# 98%

We successfully launched our B2B system in the US in 2001 with plans for progressive implementation around the world. This will move us towards a collaborative supply chain management with our customers.

In 98% of the 100 plus productivity trials conducted to date worldwide, we demonstrated conclusively to customers that use of Coats high performance corespun thread reduces the total sewing cost and increases customers' profitability.